

How Do I Refinance Business Debts or a SBA Loan?

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It is often said that small business people have very difficult time borrowing money. This is not necessarily true. Banks, particularly SBA Participating Lenders, make money by lending money. However, the inexperience of many small business owners in financial matters often prompts banks to deny requests for loans, especially requests for debt consolidation. Requesting a loan to refinance someone else's debt, that is not properly prepared or supported, sends a loud signal to your lender: *High Risk!*

A major concern for today's small business owners is access to capital and credit. SBA's loan guaranty program provides an essential source of financing for viable small businesses seeking to consolidate debt but cannot qualify for loans from traditional sources. SBA loan guarantees give small business owners, including debt consolidation, access to the same kinds of reasonably priced, long-term credit available to larger businesses by virtue of their size and economic clout. The difference is the SBA is backing you. In other words, SBA provides you with the same "economic clout" and this allows lenders to make loans to small businesses when the risk maybe higher the lenders are prepared to accept

Assume you have incurred \$150,000 in start-up debt, interim debt, dated trade payables or other loans and the cash obligations total \$5,200 every month or \$62,400 per year. A SBA guaranteed loan for this amount amortized over 10 years at the current prevailing rate is about \$2,000 per month. That's a saving of over \$26,000 per year!

Financing programs provided by the SBA vary according to a borrower's financial need. SBA loans are made by SBA Participating Lenders and are guaranteed up to 85 percent. The maximum loan amount is \$2 million and loan maturities are based on the ability of the business to repay the debt and on the original use of proceeds of the debt being refinanced. Real estate loans are limited to 25 years and working capital loans to 7-10 years. Additionally, you may use the loan proceeds to refinance an existing SBA loan. If certain conditions are met, SBA may refinance a SBA Participating Lender's debt as well as that of another lender.

To be eligible for a SBA refinancing loan, the existing debt must not presently be on reasonable terms and the refinancing must provide a **substantial benefit** to the small business. This is defined as a "*20 percent improvement to the company's cash flow as measured by the changes in the debt service requirements between the existing and new debt structures of the debt being refinanced that remains in effect over the terms of the refinanced debt.*" This means the new installment amount for the portion of the loan refinancing the debt must be at least 20 percent less than the existing installment amount. The comparison does not have to be based on similar methods of amortization. As such, principal plus interest can be compared to principal and interest.

For a business wanting to refinance a revolving line of credit or balloon note, the substantial benefit lies in the ability to stretch the payments over a longer maturity, thereby retaining its working capital for a longer period. This "terming out" will frequently benefit small businesses experiencing significant growth and is acceptable SBA refinancing justification.

The need for the business to receive lower debt payments must be thoroughly justified and the refinancing must not simply provide additional funds for distribution to the owners. If refinancing involves more than 1 debt, the combined debt payments on all the debts must satisfy the substantial benefit test of a 20 percent improvement in cash flow.

For a business wanting to refinance a revolving line of credit or balloon note, the substantial benefit lies in the ability for the business to continue to borrow once its existing line matures or its ability to stretch the payments over a longer maturity, thereby retaining its working capital for a longer period of time. This “terming out” will frequently benefit companies experiencing significant growth and is an acceptable type of refinancing if reasonably justified.

Refinancing short term debt (including credit card debt) is not subject to the 20 percent improvement to cash flow test as is required when refinancing term debt. Paying off eligible credit card debt is similar to using working capital to pay off accounts payable. Please note the credit card debt **MUST** be for business purposes and your lender will ask you for documentation to prove the credit card debt was for business purposes.

Are there other concerns we should be aware of if we are financing a loan from my bank?

Yes! Your lender must certify to the SBA that its debt is and has been current for at least the last 36 months. SBA does not refinance past due debts or loans.

Generally, SBA does NOT refinance a loan with an SBA guaranty except under very narrow circumstances. SBA believes its appropriated funds should be used to assist as many small businesses as possible and that the capital needs of businesses already supported by existing SBA loans should be accommodated through cooperation between the borrower, lender, and SBA by altering the existing terms rather than refinance for ease or convenience.

However, SBA will allow refinancing an existing SBA debt if certain conditions are met:

- If through a new lender, your new lender should contact the old lender and verify that they have declined to approve a second loan and the lender is either unwilling or unable (because of the reluctance of a secondary market investor or regulatory restriction) to modify the current payment schedule in such a way that a new lender could approve a loan without SBA’s guaranty. They must be able to document this requirement.
- A lender may refinance a loan on which it holds an SBA guaranty only if the sole reason the lender is unable to modify the terms of the existing loan is that the loan had been sold in the secondary market. The SBA expects existing lenders to cooperate in adjusting the terms of the new loan and, if necessary, the terms of existing SBA guaranteed debt so the pro forma debt structure can be handled by the expected cash flow.